

Irrecoverable Debts and Allowances

1. What is Irrecoverable Debts?

Irrecoverable **debt** is an amount that is written off by the business as a loss to the business and classified as an expense because the debt owed to the business is unable to be collected, and all reasonable efforts have been exhausted to collect the amount owed. This usually occurs when the debtor has declared bankruptcy or the cost of pursuing further action in an attempt to collect the debt exceeds the debt itself. The debt is immediately written off by crediting the debtor's account and therefore eliminating any balance remaining in that account. An irrecoverable debt represents money lost by a business which is why it is regarded as an expense.

2. What is Doubtful Debts?

Doubtful debts are those debts which a business or individual is unlikely to be able to collect. The reasons for potential nonpayment can include disputes over supply, delivery, and conditions of goods or the appearance of financial stress within a customer's operations. When such a dispute occurs it is prudent to add this debt or portion thereof to the doubtful debt reserve. This is done to avoid over-stating the asset of the business as trade debtors is reported net of Doubtful debt. When there is no longer any doubt that a debt is uncollectible the debt becomes bad or irrecoverable.

3. What is Doubtful Debts provision?

Also known as bad debt provision, this is a contra account listed within current asset section of the balance sheet. Doubtful debt reserve will hold a sum of money to allow a reduction in the accounts receivable ledger due to non-collection of debts. This can also be referred to as the allowance for bad debts. Once a doubtful debt becomes uncollectable, the amount will be written off.

Necessary Journal entries:

1. Writing off irrecoverable Debts:

Irrecoverable Debts expense (IS)	Dr
Trade Receivable (BS)	Cr

2. Whether irrecoverable Bad debts paid in the same accounting period or A subsequent one:

Cash Account	Dr
Irrecoverable Debts expense (IS)	Cr

3. On setting up an allowance irrecoverable debts:

Irrecoverable Debts expense (IS)	Dr
Allowance for Receivable (BS)	Cr

4. When a smaller allowance is needed at the end of a subsequent year:

Allowance for Receivable (BS)	Dr
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Irrecoverable Debts expense (IS)	Cr
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